

ALTERNATIVE FORECASTS

DRI has assigned a 55% probability of occurrence to its November 2000 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP advances 5.3% in 2000, 3.6% in 2001, 4.3% in 2002, 4.8% in 2003, and 3.8% in 2004;
- U.S. nonfarm employment increases 2.1% in 2000, 1.1% in 2001, 1.2% in 2002, and 2.0% in 2003, and 1.7% in 2004;
- the U.S. civilian unemployment rate remains below the full employment rate of 5.5%;
- consumer confidence declines in 2001 and 2002, but recovers in 2003;
- consumer inflation peaks at 3.4% in 2000, then bounces around 2.0% in the remaining years of the forecast;
- the federal budget surplus swells to nearly \$290 billion in 2004;
- and the U.S. merchandise trade deficit continues to widen.

While the baseline scenario represents the most likely path for the national economy over the next few years, uncertainties surrounding several key variables mean other outcomes are also possible. To account for this, DRI prepares alternative forecasts based on different assumptions regarding these key variables. Two of these alternative forecasts, along with their likely impacts on the Idaho economy, are discussed below.

HIGH OIL/HIGH DOLLAR SCENARIO

DRI's *High Oil/High Dollar Scenario* has been assigned a 20% probability of occurrence. This alternative looks into the consequences of a protracted period of high oil prices and a strong dollar. A look at a couple factors show that while this is not likely, it is possible. OPEC producers are using their current windfall profits to pay off debts and finance unmet social and infrastructure needs, not to increase crude oil production. Non-OPEC producers may hesitate to expand exploration and drilling for fear that oil prices will plunge. Eventually, oil production capacity will increase and prices will fall. In the meantime, the dollar could stay strong, since the U.S. economy will suffer less than most countries from high oil prices. The combination of a strong dollar and high, but steady, oil prices restrains inflation, allowing the Federal Reserve to keep interest rates low.

Ironically, when relief from high oil prices finally comes, it causes the economy to slow. The lower oil prices should be a boon to foreign countries, causing their economies to grow faster. As the difference between U.S. and foreign economic growth narrows, the dollar should weaken relative to foreign currencies. This would cause both domestic and foreign demand to surge. This would cause inflation to accelerate. The Federal Reserve would tighten in order to contain inflation. This policy, along with weaker foreign capital inflows, could trigger a bear market, throwing the wealth effect into reverse. Fortunately, stronger exports keep the U.S. economy from falling into a recession.

IDAHO ECONOMIC FORECAST
BASELINE AND ALTERNATIVE FORECASTS
JANUARY 2001

	BASELINE				HIGH OIL/HIGH DOLLAR				PESSIMISTIC			
	2000	2001	2002	2003	2000	2001	2002	2003	2000	2001	2002	2003
GDP (BILLIONS)												
Current \$	9,997	10,552	11,185	11,939	9,996	10,529	11,107	11,783	9,998	10,508	10,879	11,760
% Ch	7.5%	5.5%	6.0%	6.7%	7.5%	5.3%	5.5%	6.1%	7.5%	5.1%	3.5%	8.1%
1996 Chain-Weighted	9,343	9,677	10,097	10,579	9,342	9,656	10,029	10,465	9,343	9,524	9,641	10,318
% Ch	5.3%	3.6%	4.3%	4.8%	5.3%	3.4%	3.9%	4.3%	5.3%	1.9%	1.2%	7.0%
PERSONAL INCOME - CURR \$												
Idaho (Millions)	30,767	32,708	34,688	36,899	30,767	32,686	34,585	36,621	30,769	32,670	34,006	36,317
% Ch	7.6%	6.3%	6.1%	6.4%	7.6%	6.2%	5.8%	5.9%	7.7%	6.2%	4.1%	6.8%
U.S. (Billions)	8,290	8,768	9,260	9,840	8,290	8,755	9,211	9,729	8,290	8,734	9,003	9,656
% Ch	6.4%	5.8%	5.6%	6.3%	6.4%	5.6%	5.2%	5.6%	6.4%	5.4%	3.1%	7.3%
PERSONAL INCOME - 1996 \$												
Idaho (Millions)	28,642	29,964	31,309	32,684	28,642	29,932	31,201	32,475	28,640	29,469	29,846	31,517
% Ch	5.1%	4.6%	4.5%	4.4%	5.1%	4.5%	4.2%	4.1%	5.1%	2.9%	1.3%	5.6%
U.S. (Billions)	7,718	8,033	8,358	8,716	7,718	8,018	8,310	8,627	7,717	7,879	7,901	8,380
% Ch	3.9%	4.1%	4.0%	4.3%	3.9%	3.9%	3.6%	3.8%	3.9%	2.1%	0.3%	6.1%
TOTAL NONFARM EMPLOYMENT												
Idaho (Thousands)	558.6	571.3	584.8	599.1	558.6	571.2	583.7	596.6	558.6	568.7	569.5	583.5
% Ch	3.6%	2.3%	2.4%	2.4%	3.6%	2.2%	2.2%	2.2%	3.6%	1.8%	0.1%	2.5%
U.S. (Millions)	131.5	132.9	134.6	137.2	131.5	132.8	134.0	136.1	131.5	132.0	130.5	134.2
% Ch	2.1%	1.1%	1.2%	2.0%	2.1%	1.0%	0.9%	1.6%	2.1%	0.4%	-1.2%	2.8%
GOODS PRODUCING SECTOR												
Idaho (Thousands)	116.1	117.8	119.7	122.8	116.1	117.8	119.5	122.1	116.1	117.5	117.2	121.6
% Ch	2.3%	1.4%	1.6%	2.5%	2.3%	1.4%	1.4%	2.2%	2.3%	1.1%	-0.2%	3.8%
U.S. (Millions)	25.7	25.3	24.9	24.9	25.7	25.3	24.8	24.6	25.7	25.1	23.7	23.7
% Ch	0.7%	-1.4%	-1.5%	-0.1%	0.7%	-1.4%	-1.9%	-0.8%	0.7%	-2.3%	-5.6%	0.3%
SERVICE PRODUCING SECTOR												
Idaho (Thousands)	442.5	453.5	465.0	476.3	442.5	453.3	464.3	474.5	442.5	451.2	452.3	461.9
% Ch	4.0%	2.5%	2.5%	2.4%	4.0%	2.5%	2.4%	2.2%	4.0%	2.0%	0.2%	2.0%
U.S. (Millions)	105.8	107.6	109.6	112.3	105.8	107.4	109.2	111.5	105.8	107.0	106.8	110.4
% Ch	2.4%	1.7%	1.9%	2.5%	2.4%	1.5%	1.6%	2.1%	2.4%	1.1%	-0.2%	3.4%
SELECTED INTEREST RATES												
Federal Funds	6.2%	6.3%	5.9%	5.8%	6.2%	6.2%	5.5%	5.0%	6.2%	6.7%	3.8%	3.6%
Bank Prime	9.2%	9.3%	8.9%	8.8%	9.2%	9.2%	8.5%	8.0%	9.2%	9.7%	6.8%	6.6%
Existing Home Mortgage	8.0%	7.1%	6.6%	6.5%	8.0%	7.1%	6.5%	6.1%	8.0%	7.6%	6.1%	5.4%
INFLATION												
GDP Price Deflator	2.2%	1.8%	1.6%	1.9%	2.2%	1.9%	1.6%	1.7%	2.2%	3.1%	2.3%	1.0%
Personal Cons Deflator	2.4%	1.6%	1.5%	1.9%	2.4%	1.7%	1.5%	1.7%	2.5%	3.2%	2.8%	1.1%
Consumer Price Index	3.4%	2.2%	1.7%	1.9%	3.4%	2.3%	1.7%	1.7%	3.4%	3.9%	2.6%	0.8%

Forecast Begins the **THIRD** Quarter of 2000

In this scenario, Idaho's economic growth is marginally slower than in the baseline. Idaho nonfarm employment advances 2.2% annually from 2001 to 2003. In the baseline, it grows just over 2.3% per year. By 2003, Idaho nonfarm employment is 596,600, which is slightly below the baseline's 599,100. Idaho nominal personal income is also slightly lower in 2003, \$36.6 billion compared to the baseline's \$36.9 billion. This relationship persists even after adjusting for inflation. Idaho real personal income is \$32.5 billion in 2003 in this scenario. In the baseline, it is \$32.7 billion.

PESSIMISTIC SCENARIO

The *Pessimistic Scenario* has been assigned a 25% probability of occurrence. DRI has nicknamed this scenario *The Perfect Storm*. In this case, several important factors turn south at once, causing an economic tempest. It assumes a severe winter and ongoing violence in the Middle East cause oil prices to surge to \$70 per barrel. But even before oil prices spike, the euro keeps tumbling. As a result, the European Central Bank's credibility is ruined. The stronger dollar takes its toll on exports. In addition, the localized shakeout in the dot-com sector eventually infects the entire stock market, causing it to decline further. Eventually, foreigners, dissatisfied with the returns on their U.S. assets, refuse to pour funds into this country. Consumer prices take off, with inflation headed above 5%.

The Federal Reserve raises its federal funds rate in an attempt to head off inflation, but this policy eventually causes the economy to sink into a recession. The stock market panics because of the rising oil prices, higher interest rates, and a re-emerging Asian recession. The S&P 500 drops 35%. As a result, household wealth erodes, taking consumer confidence down with it. Fortunately, the recession is short lived. Several factors point toward this outcome. First, it is unlikely that oil prices will stay above \$50 per barrel. Demand should fall as the weather turns milder. Higher oil prices will eventually cause oil supplies to increase. The combination of lower demand and increased supply will cause oil prices to retreat. Second, the Federal Reserve is expected to lower interest rates in order to restart the economy, a task made easier thanks to ebbing inflation pressures. The recession starts in 2001:3 and lasts three quarters.

Not surprisingly, the major departures between this scenario and the baseline scenario start in 2001. The recession contributes to the slow growth of Idaho nonfarm employment in both 2001 and 2002. In 2001, Idaho nonfarm employment post anemic growth of just 1.8%, its weakest showing since 1987. Employment growth virtually stalls in 2002, before rallying in 2003. Unfortunately, the faster growth in 2003 does not offset the slower growth in the previous two years. As a result, Idaho nonfarm employment in 2003 is almost 16,000 lower than in the baseline. The reduced employment lowers expectations for Idaho personal income. By 2003, Idaho nominal personal income is about \$0.6 billion lower than in the baseline case, and Idaho real personal income is off by \$1.2 billion in that same year.